In the Supreme Court of the United States

OCTOBER TERM, 1955

No. 665

JACK M. CHESBRO, CARL SILVERSTEIN, MORRIS SILVERSTEIN, SMILING JACK CHESBRO, INC., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 145–159) [1] are reported in 21 T. C. 123. The opinion of the Court of Appeals (Pet. App. 1a–2a) is reported in 225 F. 2d 674.

JURISDICTION

The judgment of the Court of Appeals was entered on August 9, 1955. (Pet. App. 1a.) The

[1] The record citations refer to the separate appendix (record on review) filed jointly in the court below by the four taxpayers involved in these consolidated cases. (R. 145, Pet. App. 1a.)

taxpayers' petition for rehearing was denied on September 7, 1955. (Pet. App. 2a–3a.) By orders of Mr. Justice Reed, dated November 23, 1955, and December 27, 1955, the taxpayers' time for filing a petition for certiorari was extended to January 6, 1956, and again to February 4, 1956, both inclusive. (Pet. App. 3a–4a.) The petition for a writ of certiorari was filed on February 3, 1956. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

QUESTIONS PRESENTED

The individual taxpayers were the sole and equal stockholders of the taxpayer corporation, which bought and sold used cars. They admittedly falsified their books and income tax returns by understating receipts from sales made in violation of Office of Price Administration ceiling prices. The questions presented are:

1. Whether the Tax Court erred in refusing to accept taxpayers' general unsupported testimony that the understatements of sales prices were fully offset by understatements of purchase prices, and in finding that only a part of the understated sales was offset by understated purchases.

2. Whether the Tax Court erred in finding that income from sales made by the corporation during its fiscal year July 1, 1946–June 30, 1947, admittedly received, retained and divided by the individual taxpayer-stockholders, was taxable to

them in its entirety as dividends received during the calendar year 1947, where taxpayers failed to show what part, if any, was received in 1946.

STATUTE INVOLVED

Sections 22, 23, 41, 42, 54, and 115 of the Internal Revenue Code of 1939 are printed in the Appendix, *infra,* pp. 17–20.

STATEMENT

The pertinent facts as found by the Tax Court (R. 147–152), including by reference (R. 153) the facts (plus exhibits) stipulated by the parties, may be summarized as follows:

The taxpayers are Jack M. Chesbro, Carl Silverstein and Morris Silverstein (hereafter called Jack, Carl and Morris, respectively), and Smiling Jack Chesbro, Inc. (hereafter called the corporation), a New York corporation organized on June 18, 1946. Jack, Carl and Morris, as equal partners, formed the Smiling Jack Chesbro partnership in December, 1945, for the purpose of buying and selling used cars, and continued its operations until June 30, 1946. Their three equal interests therein were exchanged for shares in the corporation when the partnership was dissolved at the end of June 1946, and the corporation, organized to buy and sell used cars, commenced operations on July 1, 1946. The corporation operated on several lots in and around Buffalo, New York, with Morris, Carl and Jack as presi-

dent, secretary-treasurer, and vice-president, respectively, each holding one-third of the stock of the corporation. The corporation used the accrual method of accounting. (R. 147–148.)

Taxpayer Morris operated the Theatre Motor Garage as a sole proprietorship prior to April 1, 1946, when it was succeeded by Theatre Motor Sales, a partnership, consisting of Morris and Carl, which is still in existence and operating. Its main used-car lot, however, became part of the corporation at a time undisclosed by the record. (R. 148.)

Taxpayers Jack, Carl and Morris were engaged at all times material in the business of buying and selling used cars through the various business entities above-mentioned. Their used-car businesses were subject to the restrictions imposed by the then current Emergency Price Control Act of 1942, c. 26, 56 Stat. 23, *et seq.* (50 U. S. C. Appendix, 1952 ed., Sec. 901, *et seq.*), which limited the prices that could be charged for used cars. The regulations promulgated under that Act by the Office of Price Administration were in existence during 1945 and up to July 1, 1946, and thereafter again during the period August 1, 1946, to November 19, 1946, when they went out of existence permanently. The taxpayers were engaged in black-market dealings and many of their sales and some of their purchases were made at prices

in excess of those permitted by the O. P. A. regulations. (R. 148.)

The taxpayers maintained a so-called "revolving fund," begun with cash originally contributed equally by Jack, Carl and Morris, which was used by them to pay overceiling amounts for used automobiles they purchased and was augumented from time to time by the amounts of overceiling prices they received for used cars they sold. No sums in the revolving fund were ever reflected on the books of the taxpayers' several businesses. Occasionally, however, other monies from their various businesses were mingled with those of the revolving fund. Jack, Carl and Morris had access to the revolving fund and kept individual memoranda of their transactions with that fund. The lot managers would get the necessary cash from Jack, Carl and Morris and return extra cash to them. Jack, Carl and Morris would get together every few days and make settlements among themselves for monies taken in and paid out by the revolving fund, and then their individual memoranda of the fund transactions were thrown away. No records were kept of the revolving fund. The revolving fund system was used with respect to the operations of all of the above-mentioned business entities. It was adopted by the taxpayers when the O. P. A. regulations came into effect, and it helped them to evade those regulations by fraud-

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ulently [2] avoiding entries recording the payment or receipt of overceiling prices. Moreover, the taxpayers continued that method of operation and bookkeeping after the O. P. A. regulations went out of existence in November, 1946. (R. 148–149.)

The taxpayers' various businesses kept daily purchase and sales books of original entry, as required by the State of New York, a separate book being kept for each used-car lot. The information for these books, including the name and address of each vendor and vendee and the description of the car and the sales price, was supplied at the main office by Jack, Carl and Morris, and at the other lots by the lot managers. Such information was supplied on O. P. A. forms during the periods of the existence of the O. P. A., and on ordinary slips of paper thereafter. The sales price of each used car, as entered in the books, never exceeded the O. P. A. ceiling price during the periods of O. P. A. price controls. The sales and purchase prices shown on the books after the O. P. A. went out of existence varied in the same way from the actual prices and were determined by Jack, Carl and Morris. No fixed percentage of the actual

[2] The Tax Court found all the taxpayers guilty of fraud and sustained the Commissioner's imposition of 50% fraud penalties against them for all taxable years involved, under Section 293 (b) of the Internal Revenue Code of 1939, and the court below affirmed *in toto*. (Pet. App. 1a–2a.) The taxpayers, however, do not include this issue in their petition.

price was shown in every case. The taxpayers' accountants used those books to make up their various journals and other records as well as the tax returns of their several businesses. The accountants were never told about the additional purchase and sales amounts handled in the "revolving fund" but not entered in the books. (R. 149–150.)

Most purchases and sales were paid for by a combination of cash and check. The check was normally in the amount of the maximum O. P. A. price or the price shown on the books, and the cash represented the overceiling or over-book amount. The checks were shown on the corporation's books and the cash was handled through the revolving fund. The ceiling price was usually entered on the books if only cash was paid. However, checks in the amount of the ceiling prices were sometimes drawn to the order of the vendor, when cash was paid for cars, and the checks were endorsed by someone other than the vendor and cleared through the taxpayers' banks in order to have a record of the purchases as if at ceiling price. There was no fixed ratio between the amounts in cash and in checks that followed through all sales. (R. 150.)

The Commissioner's determination, after adjustments made by stipulation, was that the taxpayers had understated sales in their books in the following amounts (R. 150):

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Smiling Jack Chesbro, partnership	1946	$4,031.00
Smiling Jack Chesbro, Inc	fiscal year ended 6/30/47	97,177.75
Theatre Motor Sales, partnership	1946	11,264.00
Theatre Motor Sales, partnership	1947	7,579.13
Total		120,051.88

The Smiling Jack Chesbro partnership understated certain purchases in the amount of $405 for the year 1946. The corporation understated certain purchases in the amount of $3,973 for its fiscal year ended June 30, 1947. The record shows no other understated purchases. The Smiling Jack Chesbro partnership overstated certain purchases in the amount of $200 and the corporation overstated certain purchases in the amount of $440 for the same periods. (R. 150–151.)

The Commissioner determined that the income of the corporation for the fiscal year ended June 30, 1947, should be increased by $1,950 due to lack of substantiation of checks payable to cash and cash purchases. The record does not show that he erred in that determination. (R. 151.)

The Commissioner also determined that all of the additional profits of the corporation were distributed as dividends during 1947 to Jack, Carl and Morris. Those profits represented the understated sales of the corporation which were received in cash and handled through the revolving fund. Jack, Carl and Morris received that cash, periodically divided it equally among themselves, and at all times had complete control of it. It was not paid out for purchases or other business purposes. All unreported profits of the

corporation for its taxable year ended June 30, 1947, were thus paid to Jack, Carl and Morris as dividends. (R. 152.)

The taxpayers conceded in the Tax Court that the gross receipts from the sales of used cars were understated in their books of account and tax returns for all their businesses for the taxable years involved, both before and after the O. P. A. ceiling prices were in effect, and they neither showed error in nor attacked the total amount of these admitted understatements of unreported income, as determined by the Commissioner, after adjustments by stipulation, and redetermined and found by the Tax Court in the total sum of $120,051.88 for those years. (R. 150, 154.) Moreover, the Tax Court rejected, for failure of proof, the taxpayers' contention that—even with no support in their falsified records—it was obliged to accept their oral testimony that their asserted understatement of purchase prices for used cars was "substantially equivalent" to their admitted understatement of sales receipts. (R. 154–155.)

On the basis of the foregoing facts, the Tax Court (a) charged all the taxpayers, individual and corporate, with income to the extent of the admitted understated sales receipts which were neither recorded on their books nor reported on their tax returns, and disallowed—to the extent not substantiated by credible evidence—their asserted understatement of purchase prices claimed to have been comparable to their conceded under-

statement of sales receipts for all taxable years involved (R. 154–155), and (b) held that the three individual taxpayers each received during 1947 a dividend of $30,814.02 from the corporation in which they were the only stockholders (R. 156–157). The court below affirmed as to both issues. (Pet. App. 1a–2a.)

ARGUMENT

This case turns upon factual questions which were decided adversely to the taxpayers by both courts below. The concurrent findings of those two courts are fully supported by the record and are entitled to finality here. There is no conflict of decisions and no occasion for further review.

1. The taxpayer-stockholders concededly sold used cars on behalf of the taxpayer corporation in violation of O. P. A. ceiling price regulations, and concededly falsified the corporate and individual records and tax returns by understating the amounts of the sales proceeds. At the hearing before the Tax Court they sought to explain the discrepancy between the total amount actually received and the total amount of income recorded and reported, and thereby overcome the presumptive correctness of the Commissioner's deficiency determination, by general testimony to the effect that they had understated the purchase prices of the cars sold in amounts comparable to the understatements of sales prices. However, except for a few specific instances, as to which the

Tax Court made findings in taxpayers' favor, their testimony on this score was vague, uncorroborated, and indeed contradicted by their own records. Moreover, as the Tax Court also pointed out (R. 155), the Commissioner affirmatively proved that in four transactions the purchase prices had been overstated on the books, and that in 59 transactions the actual purchase price corresponded with that shown on the books. Under the circumstances the Tax Court was fully justified in refusing (R. 155) "to accept the general statements of [the taxpayer-stockholders] that the understatement of purchases on the books offset the understated sales to a greater degree than is disclosed by the findings of fact", and in holding that taxpayers had failed to meet the burden of proof which rested upon them.

Affirmance of the Tax Court's conclusion by the court below was clearly in accord with settled principles. The issue is purely one of fact, and under familiar rules respecting the scope of judicial review of the Tax Court's decisions it is the function of that court to weigh the evidence, pass on the credibility of witnesses, find the facts, and draw inferences from the facts. *Wilmington Co.* v. *Helvering,* 316 U. S. 164; *Commissioner* v. *Scottish American Co.,* 323 U. S. 119. Clearly, the trial court is not obliged to accept general uncorroborated testimony, even in the absence of direct conflicting testimony, where it is inherently implausible or lacks credibility. *A*

fortiori, it is not required to do so where, as here, the testimony is contradicted by other evidence. *Quock Ting* v. *United States,* 140 U. S. 417, 420–422; *Cohen* v. *Commissioner,* 148 F. 2d 336 (C. A. 2d); *Andrew Jergens Co.* v. *Conner,* 125 F. 2d 686 (C. A. 6th).

Taxpayers mistakenly claim that the decision departs from the rule enunciated by the court below in *Cohan* v. *Commissioner,* 39 F. 2d 540 (C. A. 2d). It was there held that the Tax Court should have allowed the taxpayer to deduct some amount of claimed expenses, however small, where it found that he had made some deductible expenditures but had failed to prove the amount. However, as the court below pointed out (Pet. App. 1a–2a), its holding in that case has no applicability here, since in this case the Tax Court did allow amounts claimed by taxpayers to have been expended as the purchase price of goods sold to the extent that it found credible evidence to support such expenditures, and it did so even in the absence of supporting books of account.

2. The court below also properly sustained the Tax Court's determination (R. 156–157, 160–161) that the unreported corporate income for the corporation's fiscal year ended June 30, 1947—the conceded understated sales receipts of the corporation which the stockholder-taxpayers received, retained, and divided in equal shares—was taxable to them as dividends constructively received

in 1947.[3] Although the propriety of taxing any portion of this corporate income to the stockholders was at first challenged by them (R. 156), they subsequently abandoned that position. Instead, they contended upon a motion to vacate the Tax Court's decision (R. 160), as they do here (Pet. 3, 15), that part of the income was received and taxable in 1946 and that consequently it was error to hold that all of it was received and taxable in 1947. The Tax Court denied the motion on the ground that the taxpayers "have not shown what part of the total was actually received in 1946, although it is fair to assume that some part was received in that year" (R. 160); and on the further ground that "neither the Commissioner nor the Court could tell what the amounts represented until the close of the fiscal year of the corporation when it became apparent that the individuals intended to retain the overceiling sales prices which they had not turned in to the corporation." (R. 161.) In the absence of satisfactory evidence upon which an allocation of the receipts as between the years 1946 and 1947 could be made, the Tax Court was clearly justified in holding that the taxpayers had failed to meet the burden of proving the Commissioner's determination to be incorrect, and the court below was equally justi-

[3] While the corporation reported its income on the basis of a fiscal year ended June 30, the individual taxpayers reported their incomes on a calendar year basis. (R. 146.)

fied in affirming. *Interstate Transit Lines* v. *Commissioner,* 319 U. S. 590, 594.

There is no warrant for taxpayers' assertion (Pet. 8–9) that the courts below disregarded the principle of annual tax accounting, and the cases upon which they rely for conflict in this connection (Pet. 10–14) are patently inapposite. The question in those cases was whether a taxpayer who receives income in one year under a "claim of right" is required to report the income in that year, even though he may be required to restore the income in a later year, and it was held that the income must be accounted for in the year received. No such question is presented here. The only issue here is what part of an amount concededly representing income in the year it was received was actually received in 1946, and what part was actually received in 1947. In the absence of evidence from which an apportionment could be made, the Tax Court's determination that it was all received in 1947 should not be disturbed.

Moreover, as the Tax Court also held (R. 161), since the corporation's fiscal year ended on June 30, 1947, it could not be known with certainty until then whether there were dividends available for distribution. In the circumstances of this case, where the truth had to be dug out from under the extensive frauds of the taxpayers (a point they no longer dispute, fn. 2, *supra,* p. 6), it was clearly proper to charge them with this

income, under settled accounting principles, in 1947.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

SIMON E. SOBELOFF,
Solicitor General.
CHARLES K. RICE,
Acting Assistant Attorney General.
HARRY BAUM,
S. DEE HANSON,
Attorneys.

MARCH 1956.

APPENDIX

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Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(e) *Distributions by Corporations.*—Distributions by corporations shall be taxable to the shareholders as provided in section 115.

* * * * *

(26 U. S. C. 1952 ed., Sec. 22.)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [As amended by Sec. 121 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any

trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 23.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

(26 U. S. C. 1952 ed., Sec. 41.)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) [As amended by Sec. 114 of the Revenue Act of 1941, c. 412, 55 Stat. 687] *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 42.)

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By Taxpayer.*—Every person liable to any tax imposed by this chapter or for

the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

* * * * *

(26 U. S. C. 1952 ed., Sec. 54.)

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) [As amended by Sec. 166, Revenue Act of 1942, *supra*] *Definition of Dividend.*—The term "dividend" when used in this chapter (except in section 201 (c) (5), section 204 (c) (11) and section 207 (a) (2) and (b) (3) (where the reference is to dividends of insurance companies paid to policy holders)) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of Distributions.*—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribu-

tion shall be applied against and reduce the adjusted basis of the stock provided in section 113.

* * * * *

(26 U. S. C. 1952 ed., Sec. 115.)

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